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Supreme Court of the United States

October Term, 1944

No. 410

In the Matter of Proposed Reorganization of THE WESTERN TOOL & MANUFACTURING COMPANY, a Corporation,
Debtor,

OWEN N. PRICE, Trustee for Bondholders of The Western Tool & Manufacturing Co., and ROY MASSENA, E. J. PRICE, W. D. HOLLISTER and W. T. KETTERING, Bondholders' Protective Committee for Holders of Bonds of The Western Tool & Manufacturing Co.,
Petitioners,

vs.

JAMES G. GURNEY, Individually and on Behalf of Other Shareholders of The Western Tool & Manufacturing Co., and THE WESTERN TOOL & MANUFACTURING COMPANY, a Corporation,
Respondents.

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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We note that counsel charge (in the first sentence of their Brief), that the Petition is replete with misstatements and a promise is made to point them out some other time. We suggest that in their reasonably long Brief some of these might have been pointed out.

Since filing our main Brief we have seen a very recent case to which we should call attention:

John Hancock Mutual Life Ins. Co. v. *Casey,* 141 Fed. 2nd 104, (October, 1943), is a case somewhat similar to the present one. There the mortgagee, "as the holder of the first mortgage and by itself the senior and largest class of creditors, has made it patently clear that it will not accept any plan of reorganization which involves any relinquishment of its rights under the mortgage." (p. 107). It was held that a reorganization was either unnecessary or impossible. In the present case reorganization is impossible or unnecessary since any plan, in order to be approved by the Court, must be acceptable to the mortgagee, and if acceptable no court proceedings are called for.

CRITICISM OF MANAGEMENT

It will be observed that the main point of difference between the parties involved in this matter is as to the management of the business affairs of this Company. Mr. Gurney, who filed the Petition for Reorganization, believed the profits of the Company should be devoted to new equipment, going into new lines of production, instead of paying debts, and also that money be borrowed for the same purpose. Of course money could be borrowed only by securing it prior to the bonds. The other members of the Board of Directors disagreed with Mr. Gurney and decided to run the Company more conservatively, paying upon its debts as they could. We believe a careful observer would agree with the latter, especially considering the results of the last few years, but this is immaterial since the Court will not interfere with the management of the Company unless there is fraud or bad faith.

COMPLAINTS OF NEGLECT AND WRONG-DOING

The directors are repeatedly accused of neglect and wrongful acts. This is usually stated in general terms (p. 8), to the effect that they were seeking to extinguish the stockholders' equity and appropriate the assets for the benefit of the bondholders, but no particular acts of this kind are pointed out, counsel relying upon their complaint that the directors did not borrow money, reequip, enter into new lines, etc. The directors are repeatedly accused of neglect and wrongful act in not seeking a reorganization, (10, 12, 14, 16). We have already (main Brief 24), pointed out that the corporation itself has no legal obligation to file a petition to reorganize. Such action must be the result of the exercise of discretion as to whether it would be wise and whether there is a necessity therefor. It is constantly assumed by counsel that a proceeding for reorganization would be of great benefit to the corporation and stockholders. How that would be is not pointed out. In fact, a reorganization could be of no benefit to stockholders, unless it changed the rights of the only creditors, the bondholders, which could not be done without their consent, and naturally they would not and do not consent thereto.

Counsel, in attempting to show wrong-doing on the part of the directors, say (p. 17) that the directors caused the corporation to vote to themselves as a Bondholders' Committee $1000.00, as might be requested for expenses. The Record (p. 48) shows that the directors authorized payment to the Bondholders' Committee of not to exceed $1000.00, but with "proper credit to be given in future settlement between the Committee and the Company". Of course it was proper to pay the bondholders and whether

the Committee chose to use it for expenses or not is not material. But the payment was not made, (R. 28), probably because the Committee never called for it.

Complaint is made of payments to attorneys and the Trustee (p. 7), by the Receiver. These payments were made by order of the Court prior to the reorganization proceedings.

The letter of Enoch J. Price, (R. 65-7) written before any controversy arose, is self-explanatory and we commend it to the Court as a full and frank statement of the history and condition of this concern. It gives an unprejudiced picture of the situation confronting the Bondholders' Committee and their earnest and honest efforts to work matters out for the benefit of all concerned. That it is a truthful, friendly statement is apparent on the face of it.

A POSSIBLE METHOD OF REORGANIZATION

If the reorganization included putting in additional capital by or for the stockholders, there might be some prospect of successful reorganization. Any displacement of the lien of the mortgage bondholders in favor of new lenders could only be done with their consent, which could be arranged, if at all, directly with the bondholders and no reorganization proceedings would be needed or appropriate.

It is plainly apparent that no one will contribute capital to rehabilitate this corporation. Evidently the stockholders will not for their only suggestion is that money be borrowed. The bondholders, (after twenty-three years of holding these bonds, all of which are long overdue), will not put in further money. Either borrowing money or using earnings would be a contribution by bondholders. Outside capital could only be obtained, if at all, by securing

it ahead of the bondholders, which would in effect be a contribution by bondholders and likewise taking, for that purpose, earnings of the receivership in the foreclosure proceeding would be an appropriation of funds rightfully belonging, under the terms of the Mortgage Deed of Trust, to the bondholders. All of which would be a hazardous speculation, not to be entered into without the mortgage bondholders' consent.

STATUTE DOES NOT PERMIT STOCKHOLDER TO FILE PETITION

Counsel, while admitting that the statute, Section 126, does not authorize stockholders to file a petition for reorganization, at the same time claim that that section should be deemed to read as if stockholders were entitled to appear for the corporation. (p. 13). This is a clear attempt to read into the statute a provision that is definitely omitted and stamps their whole claim as unsound. The fact that the stockholders are expressly authorized (Secs. 136, 207) to appear in later stages of the proceeding makes it clear that they are not to be included in the section authorizing the filing of the petition.

The curious argument is made (pp. 10, 11) that because the directors did not file a petition for reorganization, stockholders are entitled to do so. How such a result follows is not shown. Nor does it appear why the statute is to be enlarged because the directors do not determine to file the petition.

PREVIOUS RECORD OF CORPORATION

Counsel contend (p. 15) that there is no evidence to support our statement that a program similar to the one

that Gurney now insists upon had been ill-advised and resulted in heavy loss during the First World War. Upon this point we call attention to pages 66 and 32 of the Record. That this bond issue was made in 1921 to pay piled up debts is sufficient to show the failure of the Company to have profited by their conduct of business during the First World War.

LACHES

Counsel seem to feel the charge of laches has importance for they repeatedly profess to answer it by saying that upon the bringing of the foreclosure suit, (which they knew of at the time it was brought), they immediately retained counsel, (pp. 7, 21). Due diligence is not shown by merely employing a lawyer. They had ample knowledge and ample time to raise any question desired in the foreclosure suit and the record shows not a thing was done. A capable attorney was employed but, either because he found no ground for action or was not authorized, he did not act.

The matters complained of occurred or began long years ago, such as the continuance of the Voting Trust and the alleged dispute as to the rate of interest, and no action was taken. The complaint about the Voting Trust came first in 1942, just before the bringing of the foreclosure suit, (Respondent's Brief, pp. 6-7), and interest was ordered paid by the Directors without regard to any agreement to reduce same as late as September, 1941, at a meeting attended and participated in by Mr. Gurney, (R. 49, see also minutes of meeting of March 28, 1941, R. 46.)

The claim is made in this connection that the Voting Trust had terminated. This is not important because the same directors continued in charge and the same bond in-

debtedness continued. As was said by Judge Nevin, (but not in the Record), this is not the place to have the question of the termination of the Voting Trust litigated.

DUTY OF CORPORATION TO MAKE DEFENSE IN FORECLOSURE SUIT.

Counsel reiterate that the Board of Directors failed to make a defense in the foreclosure suit but they claim no defense of any sort, except as to a part of the interest and after five months' opportunity to make such a question they failed to do so. We submit that the corporation and the complaining stockholders having had opportunity to call that matter in question, it became adjudicated by the judgment in that case.

SOLVENCY OF THE CORPORATION.

Counsel apparently concede the insolvency of the corporation in their statement (p. 28) that there will be a large deficiency in case of the sale of the assets of the Company.

In arguing that the Company is solvent and therefore the stockholders are interested, it is contended that there was no failure of proof of solvency but lack of opportunity to present the same (p. 24). The fact is, as the Record shows (R. 84-89), the petitioner below offered statements of the financial condition of the Company, which showed insolvency. Now, however, counsel contend (p. 24-26), that the Company is solvent based upon what is said to be a balance sheet of December 31, 1943, and income tax return of 1943. None of this, of course, is in the Record for the statements cover periods subsequent to the hearing in the District Court. That ought to be a sufficient answer

to what is stated, but the fact is the only change from the previous statements of condition is that the Receiver made a profit in war work. That work has been declining and probably will in the course of a short time disappear. Then, presumably, the Company will be back in its former hopeless condition.

RIGHT OF BONDHOLDERS' COMMITTEE TO ACT.

Counsel claim, (pp. 26-27), that the Bondholders' Committee has no right to participate in the reorganization proceeding and cite *In re Loeb Apartments*, 89 Fed. 2nd, 461, to the effect that the Committee has no authority to object to the filing of the Petition. This case was under Sec. 77B which provided only for creditors or stockholders to be heard. (See Sec. 77B (c) (11) as that law stood prior to the amendment of August 27, 1935). The present law on that subject is in Section 207 of the Chandler Act, (11 U. S. C., Sec. 607), which permits "a party in interest" to intervene.

Section 209 expressly provides that a creditor may act by a duly authorized committee. The Bondholders' Committee's authority was shown by the Bondholders' Agreement. (R. 80).

CONCLUSION.

We submit that the questions involved here are of sufficient importance for final determination by this Court. The Federal Courts, which have such importance and control of business affairs under the Bankruptcy Act, especially Chapter X, should have guidance in this matter. Business corporations, bondholders and stockholders likewise are

entitled to an interpretation of this Federal statute. As construed by the Circuit Court of Appeals this statute will invite minority stockholders to threaten and interfere with corporations on grounds sufficient to make trouble and cause loss but with no reason for court interference.

Respectfully submitted,

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